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CREDIT OPINION
7 April 2017

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RATINGS

SEMCO Energy, Inc.

Domicile	Port Huron, Michigan, United States
Long Term Rating	Baa1
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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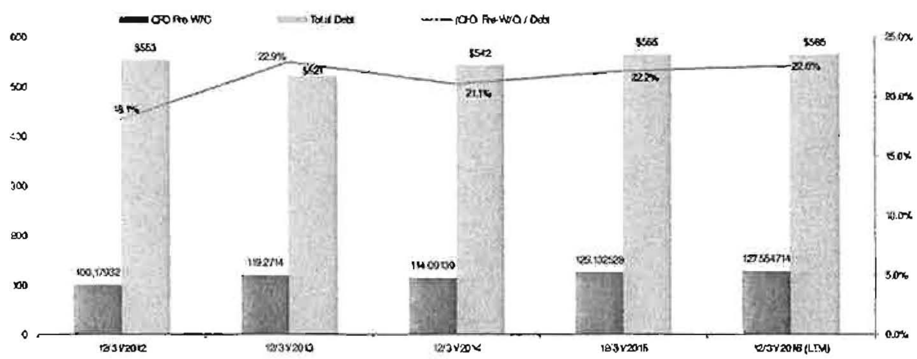
SEMCO Energy, Inc.

Regulated Local Gas Distribution Utility

Summary Rating Rationale

SEMCO Energy's (SEMCO, Baa1 Stable) Baa1 Issuer Rating reflects the low risk business profile of its regulated local gas distribution (LDC) operations and the credit supportive regulatory environments in Michigan and Alaska, providing timely cost recovery mechanisms and reasonable authorized return on rate base. The rating is also supported by strong and transparent financial metrics, including Moody's adjusted cash flow from operations before changes in working capital (CFO pre-WC) to debt in the low 20% range. We continue to rate SEMCO as a stand-alone entity, unaffected by its parent AltaGas Limited's (AltaGas, not rated) consolidated credit risk profile, so long as AltaGas' other operations and liquidity programs do not intertwine with SEMCO's, and SEMCO's conservative financial policies remain intact.

Exhibit 1
Historical CFO Pre-W/C, Total Debt and CFO Pre-WC to Debt



Source: Moody's Financial Metrics

Credit Strengths

- » Credit supportive regulatory environments in Michigan and Alaska
- » Some diversity in revenue through gas storage operation
- » Stable financial metrics expected to continue

Date: 6-6-16 Exh # H-12
Regulatory Commission of Alaska
U-16-066 By: APS
Northern Lights Realtime & Reporting, Inc.
(907) 337-2221

ENS08235

Credit Challenges

» Small in size and scale

» Customer growth slightly offset by flat customer gas usage

Rating Outlook

SEMCO's stable outlook reflects our expectation of predictable and steady cash flow generation, credit supportive regulatory jurisdictions, and capital expenditures and financial policies that maintain SEMCO's current financial position and flexibility. This includes a ratio of CFO pre-WC to debt in the low 20% range and debt to capitalization below 50%. The stable outlook also incorporates our expectation that SEMCO will operate as a stand-alone entity under the ownership of AltaGas and maintain conservative financial policies.

Factors that Could Lead to an Upgrade

» A rating upgrade could be considered if SEMCO's regulatory environments improve materially, further shortening regulatory lag and having a positive impact on the company's financial profile. Also, if SEMCO's CFO pre-WC to debt reaches mid-20% range on a sustained basis, an upgrade could be possible.

Factors that Could Lead to a Downgrade

» A rating downgrade could be considered if SEMCO's regulatory jurisdictions become less credit supportive, such that regulatory lag increases or cost recovery is negatively affected. Separately, SEMCO's rating could be downgraded if its financial metrics deteriorate and remain weak for the rating, such that CFO pre-WC to debt declines to the mid-teens on a sustained basis. Additionally, if the company's financial policies become more aggressive, including sizeable debt-financed dividend distributions to its parent, the rating could be negatively affected.

Key Indicator

Exhibit 2

KEY INDICATORS [1]

SEMCO Energy, Inc. -Private

	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016
CFO pre-WC + Interest / Interest	5.0x	5.8x	5.9x	6.1x	6.2x
CFO pre-WC / Debt	18.1%	22.9%	21.1%	22.2%	22.6%
CFO pre-WC – Dividends / Debt	17.5%	21.1%	18.3%	2.9%	19.4%
Debt / Capitalization	45.8%	42.1%	41.3%	44.1%	42.7%

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Source: Moody's Financial Metrics

Detailed Rating Considerations

Stable regulatory environments in Michigan and Alaska

SEMCO generates almost all of its revenues from its regulated gas distribution and gas storage businesses in Michigan and Alaska, which provide stable and predictable cash flows. Approximately two-thirds of SEMCO's customers are in Michigan with the remaining one-third in Alaska. The regulatory jurisdictions of Michigan and Alaska are constructive and provide timely cost and investment recovery mechanisms. SEMCO's operation in Michigan utilizes a gas cost recovery (GCR) mechanism in Michigan and similarly, ENSTAR, SEMCO's operating utility in Alaska, utilizes a gas cost adjustment (GCA) pricing mechanism in Alaska, approved by the

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Michigan Public Service Commission (MPSC) and the Regulatory Commission of Alaska (RCA), respectively. These allow for the cost of purchased gas to be passed onto its customers on a timely basis.

We view the Michigan regulatory environment to be an above-average regulatory jurisdiction in terms of credit supportiveness. Gas utilities in Michigan are allowed to use a forward test year in rate base filings and, by law effective 20 April 2017, the rate cases must be decided within ten months of the date of filing. Otherwise the utility's application is automatically approved as filed. In 2015, the MPSC approved SEMCO's filing to continue its Main Replacement Program (MRP) for an additional five years with average annual capital expenditures of $10.1 million, ensuring more timely recovery of the company's system safety and reliability investments. Based on its last rate case settlement in January 2011, SEMCO is authorized a 10.35% return on equity (ROE) based on a 55% equity ratio in Michigan.

In Alaska, SEMCO is one of only two investor owned utilities in the state and the RCA primarily regulates co-operatives whose rate cases do not have a ROE component. In June 2016, ENSTAR filed a general rate case requesting a revenue increase of $11.8 million based on a 12.55% ROE. As a part of the filing, ENSTAR requested, and granted, to increase rates on an interim and refundable basis beginning 1 August 2016 by 1.6% of total revenue. A final order on the filing is expected in the third quarter of 2017. In addition to the rate change request, ENSTAR requested to include the natural gas storage reservation and capacity fees as a specific component and account as a cost in the company's gas cost adjustments. The RCA approved the change in methodology and the change became effective in October 2016. The change will now allow the company to recover the storage reservation and capacity fees on an annual basis.

Some revenue diversity and regional supply flexibility from gas storage facility

SEMCO operates and owns 65% of the Cook Inlet Natural Gas Storage Alaska, LLC in-field storage facility (CINGSA), which was placed into service in November 2012. CINGSA provides natural gas storage services to ENSTAR and three Cook Inlet area electric utilities as well as interruptible services to five other customers. ENSTAR has subscribed for approximately two-thirds of the gas injection and withdrawal capability of CINGSA, with the remainder split among the other customers. Although 99% of the company's consolidated operating revenues are attributed to regulated businesses operations, we believe CINGSA's importance lies in maintaining an adequate supply of natural gas to meet customers' seasonal consumption demands. ENSTAR has obtained firm gas supply contracts through the first quarter of 2023.

Even with an increase in storage inventory in Alaska as new exploration has produced increased gas supplies, the State of Alaska continues to investigate ways to bring additional natural gas and/or LNG supply into south-central Alaska. In April 2014, ENSTAR entered into a two-year LNG import license to import approximately 40 Bcf from the Cook Inlet area, which was renewed for an additional two years in February 2016.

The potential sale of native gas discovered by CINGSA remains uncertain. CINGSA appealed the RCA's December 2015 order to allocate 87% of the proceeds of the sale to CINGSA's customers. Oral argument on the appeal was completed in March 2017 and a court decision is pending. CINGSA discovered a pocket of native gas totaling 14.5 billion cubic feet (Bcf). All of the 14.5 Bcf is not necessary to provide pressure support for CINGSA's storage operations. As a result, CINGSA is considering a sale of this native gas.

Potential large pipeline investment in Michigan

SEMCO is pursuing an investment to construct the Marquette Connector Pipeline (MCP) in Michigan. In December 2016, it filed an Act 9 application with the MPSC seeking an approval to construct a new lateral from the Great Lakes pipelines to Marquette, Michigan. The total cost, including allowance for funds used during construction (AFUDC), is approximately $140.3 million. The MCP will add a new source of gas supply and redundancy to the system in Upper Peninsula of Michigan. The final decision on the Act 9 application is expected in the fourth quarter of 2017. The construction should begin in 2019 and the pipeline should be in service in mid-2020.

Consistent financial metrics with stable cash flows

Over the last three years, SEMCO's financial metrics have been consistent based on its stable cash flows and earnings. Also, its equity and debt levels remained consistent in the same period. In the period ending 31 December 2016, SEMCO's Moody's adjusted CFO pre-

WC to debt was 22.6% and the metric's three-year average was 21.9%. We expect SEMCO to maintain a slightly lower level of metrics over the next 12-18 months where the CFO pre-WC to debt ranging 18%-21%, appropriate for its rating.

Although SEMCO made a significant dividend payment of $109 million in 2015, we view this as one-time in nature and do not expect SEMCO to make any significant dividend to the parent in 2017.

It is possible that SEMCO's key metrics will be slightly weakened until the MCP is completed. We expect SEMCO to finance this pipeline investment with its internally generated cash flows and short-term borrowings through its credit facility. However, we do not anticipate a significant deterioration in the company's financial profile or credit metrics during the construction period.

Excluding capital expenditure related to MCP, we expect SEMCO's 2017 capital expenditure to be comparable to the 2016 level. SEMCO continues to invest in new customer addition in both Michigan and Alaska. Main replacement capital expenditure in 2017 should be similar to the 2016 spending.

Liquidity Analysis

We expect SEMCO to maintain adequate liquidity over the next 12-18 months.

SEMCO has a $150 million unsecured revolving credit facility, which expires in December 2021. As of 31 December 2016, SEMCO had $62.5 million of availability, net of the $87.5 million drawn and $0.5 million of letters of credit outstanding. Due to the seasonality of the business, SEMCO's revolver draws tend to peak in Q4 as gas is purchased and stored in preparation for the winter season. SEMCO's facility has two financial covenants, including a minimum interest coverage ratio of 2.25x and a maximum debt to capitalization ratio of 60%. As of 31 December 2016, the company was in compliance with these covenants at 6.61x and 45.3%, respectively.

During 2016, SEMCO's reported cash flow from operations was $84 million, consistent with historical levels. The company's 2015 $165 million reported cash flow from operation was considerably higher than historical levels, due to positive swings in working capital items. We expect cash flow from operation in 2017 to be in the $80 - $100 million range.

SEMCO's next significant debt maturity is a $45 million Promissory Note due in August 2017. It is expected to be renewed for another three to five years. The next maturity after that is $300 million Senior Note due in April 2020.

Corporate Profile

SEMCO Energy, Inc. (SEMCO), headquartered in Port Huron, Michigan, owns and operates regulated natural gas local distribution companies (LDCs) serving about 443,000 customers in the Upper and Lower Peninsula of Michigan and in Anchorage, Alaska. The Michigan distribution operation is referred to as SEMCO Gas Company (SEMCO Gas) and the Alaska distribution operation is referred to as ENSTAR Natural Gas Company (ENSTAR). SEMCO is a wholly-owned subsidiary of SEMCO Holding Corporation (SHC, not rated), which is a wholly-owned subsidiary of AltaGas Utility Holdings (U.S.) (not rated), which is an indirect wholly-owned subsidiary of AltaGas Limited (AltaGas, not rated), a Canadian energy infrastructure company comprised of gas, power and utilities businesses.

Rating Methodology and Scorecard Factors

Exhibit 3

Rating Factors				
SEMCO Energy, Inc. -Private				
Regulated Electric and Gas Utilities Industry Grid [1][2]	Current FY 12/31/2016		Moody's 12-18 Month Forward View As of Date Published [3]	
Factor 1 : Regulatory Framework (25%)	**Measure**	**Score**	**Measure**	**Score**
a) Legislative and Judicial Underpinnings of the Regulatory Framework	A	A	A	A
b) Consistency and Predictability of Regulation	A	A	A	A
Factor 2 : Ability to Recover Costs and Earn Returns (25%)				
a) Timeliness of Recovery of Operating and Capital Costs	A	A	A	A
b) Sufficiency of Rates and Returns	Ba	Ba	Ba	Ba
Factor 3 : Diversification (10%)				
a) Market Position	Baa	Baa	Baa	Baa
b) Generation and Fuel Diversity	N/A	N/A	N/A	N/A
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	6.1x	Aa	5.7x - 6.3x	A
b) CFO pre-WC / Debt (3 Year Avg)	21.9%	A	18% - 21%	A
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	13.4%	Baa	13% - 15%	Baa
d) Debt / Capitalization (3 Year Avg)	42.7%	A	42% - 46%	A
Rating:				
Grid-Indicated Rating Before Notching Adjustment		A3		A3
HoldCo Structural Subordination Notching	0	0	0	0
a) Indicated Rating from Grid		A3		A3
b) Actual Rating Assigned		Baa1		Baa1

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 12/31/2016.
[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.
Source: Moody's Financial Metrics

Ratings

Exhibit 4

Category	Moody's Rating
SEMCO ENERGY, INC.	
Outlook	Stable
Issuer Rating	Baa1
Senior Secured	A2

Source: Moody's Investors Service

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